



Cavusgil **Knight** **Riesenberger**

International Business

The New Realities

Third Edition



Part 1

Chapter 1

Introduction: What Is International Business?

by

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Learning Objectives

1. What is international business?
2. What are the key concepts in international trade and investment?
3. How does international business differ from domestic business?
4. Who participates in international business?
5. Why do firms internationalize?
6. Why study international business?



Facebook: A Global Phenomenon

1. Exemplifies globalization and converging lifestyles.
2. One of every eight people, roughly one billion users, has a Facebook account.
3. Some 70 percent of Facebook users live outside the United States and speak over 75 languages.
4. Facebook managers use foreign direct investment to establish offices around the world.
5. Millions use Facebook to make friends, worldwide.
6. Illustrates how converging lifestyles, communications technology, and imaginative entrepreneurship are facilitating the emergence of global enterprises.



A Day in the Global Economy – Julie Valentine

In the Opening Vignette, while visiting a shopping mall, Julie Valentine:

- Ate food from Argentina, Brazil, Costa Rica, France, Italy, and Spain;
- Used or shopped for various items, including cars, clothing, and electronics, from China, Finland, France, Indonesia, Germany, Hungary, Japan, Malaysia, Mexico, Netherlands, South Africa, South Korea, Taiwan, and several other countries.
- Like you, Julie's life is touched everyday, in various ways, by international business.



Key Concepts in International Business

- **International business:** Performance of trade and investment activities by firms across national borders.
- **Globalization of markets:** Ongoing economic integration and growing interdependency of countries worldwide.



The Nature of International Business

- All value-adding activities – including sourcing, manufacturing, and marketing – can be performed in international locations
- International trade can involve products, services, capital, technology, know-how, and labor
- Firms internationalize through various entry strategies, such as exporting and foreign direct investment



Key Concepts (cont'd)

- **International trade:** Exchange of products and services across national borders; typically through exporting and importing.
- **Exporting:** Sale of products or services to customers located abroad, from a base in the home country or a third country. Boeing and Airbus export billions in commercial aircraft every year.
- **Importing or Global Sourcing:** Procurement of products or services from suppliers located abroad for consumption in the home country or a third country. Toyota imports many parts from China when it manufactures cars in Japan.



Key Concepts (cont'd)

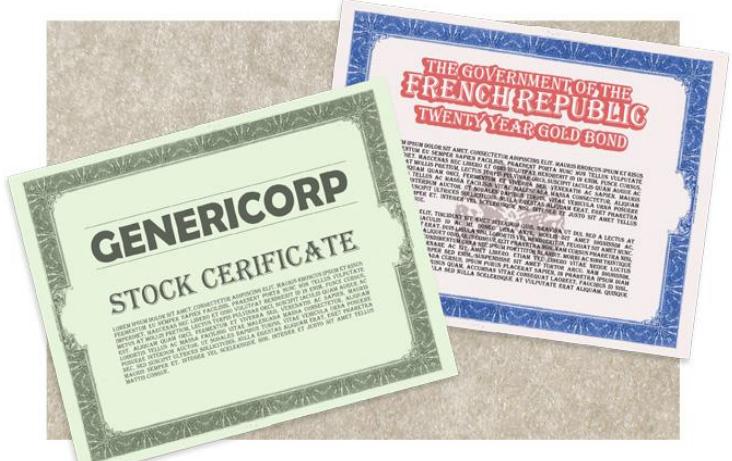
International investment: Transfer of assets to another country or the acquisition of assets in that country. Also known as 'foreign direct investment' (FDI), we will focus on this type of investment.

- These assets include capital, technology, managerial talent, and manufacturing infrastructure. Economists refer to such assets as factors of production.
- **Trade** implies that products and services cross national borders. By contrast, **investment** implies the firm itself crosses borders to secure ownership of assets located abroad.



Key Concepts (cont'd)

International portfolio investment: Passive ownership of foreign securities such as stocks and bonds, in order to generate financial returns.



Key Concepts (cont'd)

Foreign direct investment (FDI) is an internationalization strategy in which the firm establishes a physical presence abroad through acquisition of productive assets such as capital, technology, labor, land, plant, and equipment.

- It is a foreign-market entry strategy that gives investors partial or full ownership of a productive enterprise typically dedicated to manufacturing, marketing, or management activities. Investing such resources abroad is generally for the long term and involves extensive planning.



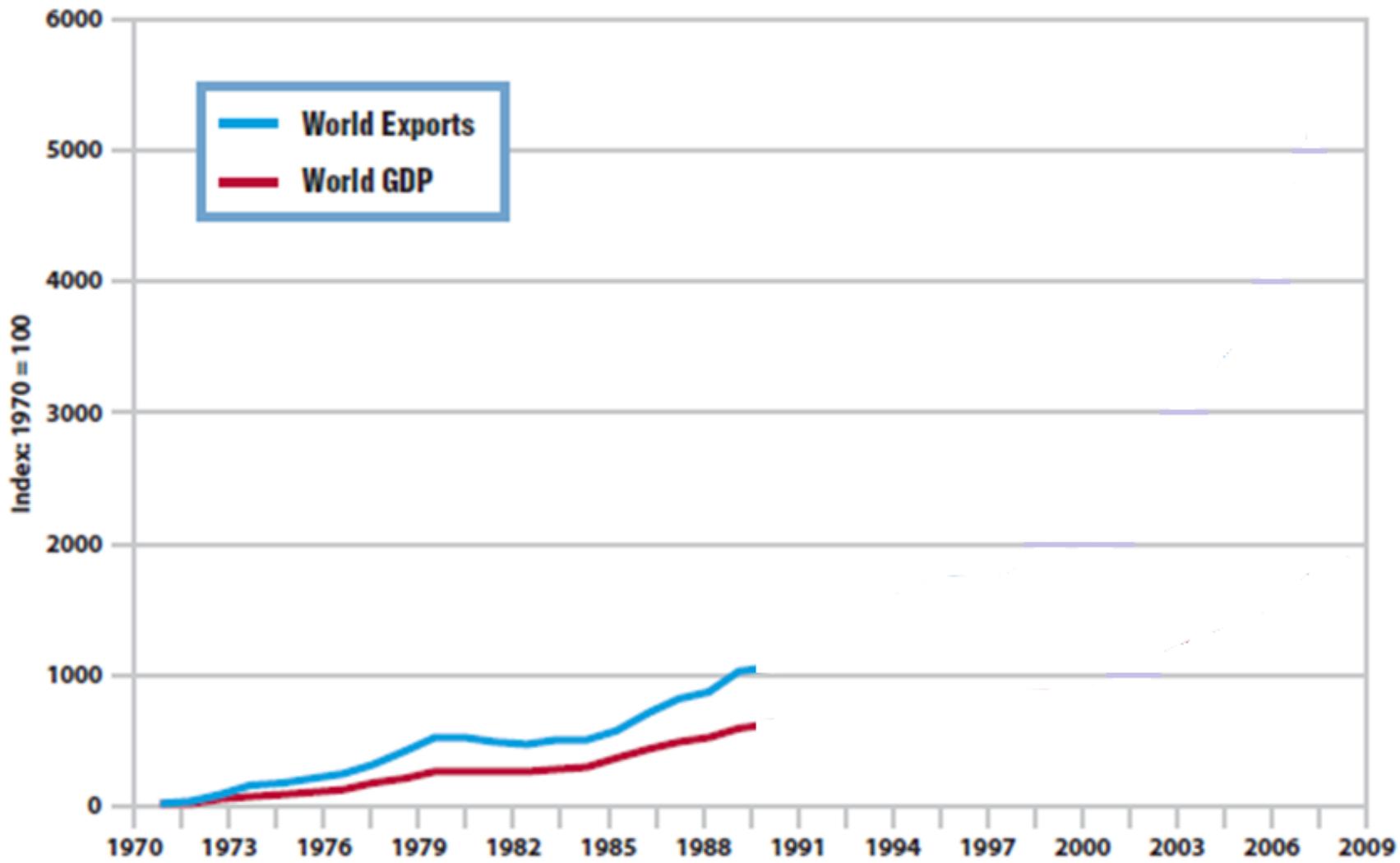
The ‘Flows’ of International Business



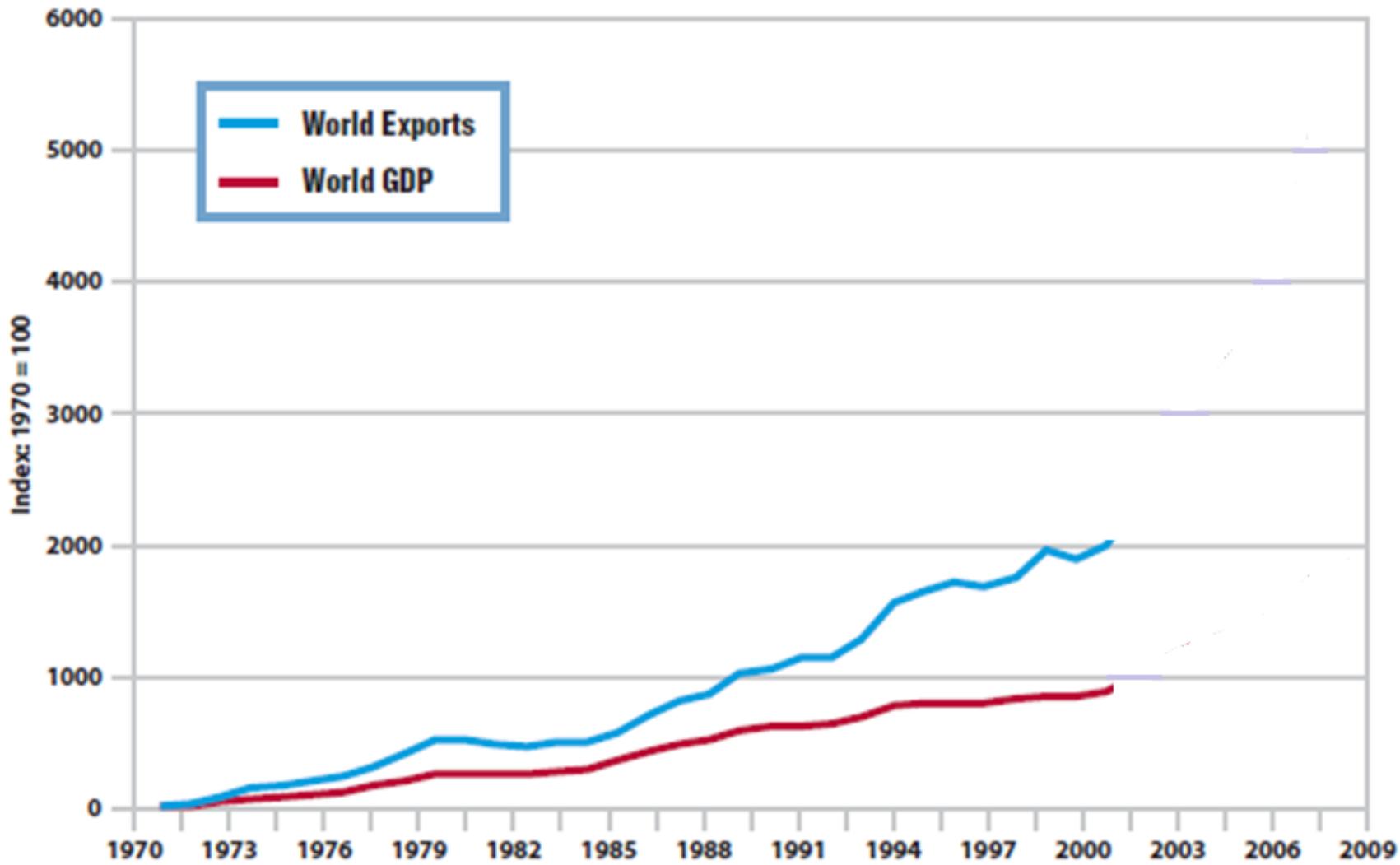
The ‘Flows’ of International Business

- The globalization of markets is evident in several related trends.
- First is the unprecedented growth of international trade.
- Second, trade between nations is accompanied by substantial flows of capital, technology, and knowledge.
- Third is the development of highly sophisticated global financial systems and mechanisms that facilitate the cross-border flow of products, money, technology, and knowledge.
- Fourth, globalization has brought about a greater degree of collaboration among nations through multilateral regulatory agencies such as the World Trade Organization and the International Monetary Fund.

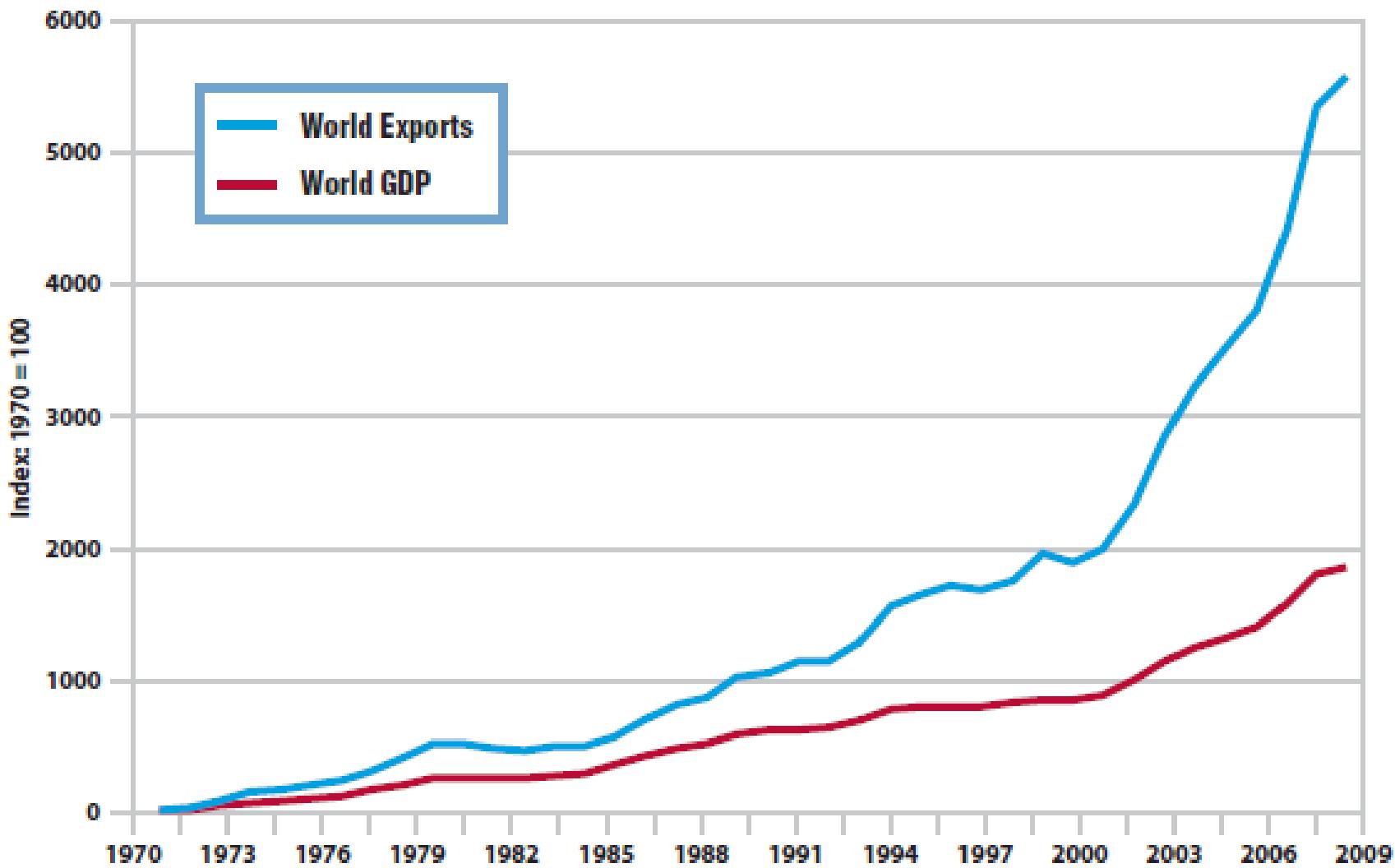
World Trade Is Growing Faster than GDP



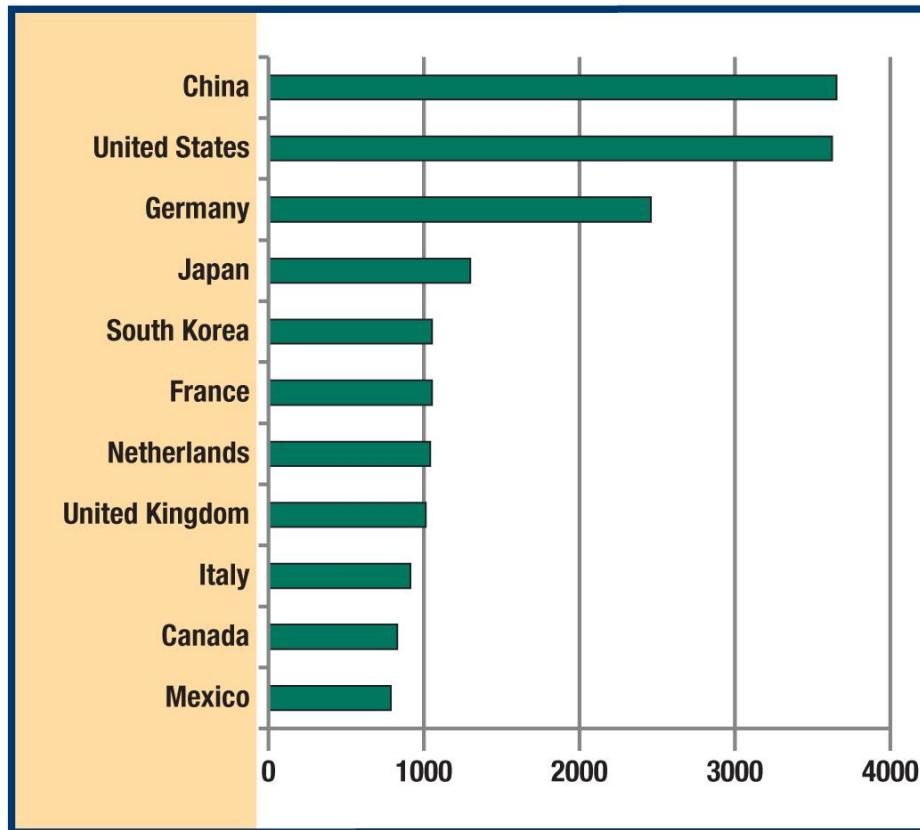
World Trade Is Growing Faster than GDP



World Trade Is Growing Faster than GDP



Leading Countries in International Merchandise Trade, by Total Annual Value, \$Billions

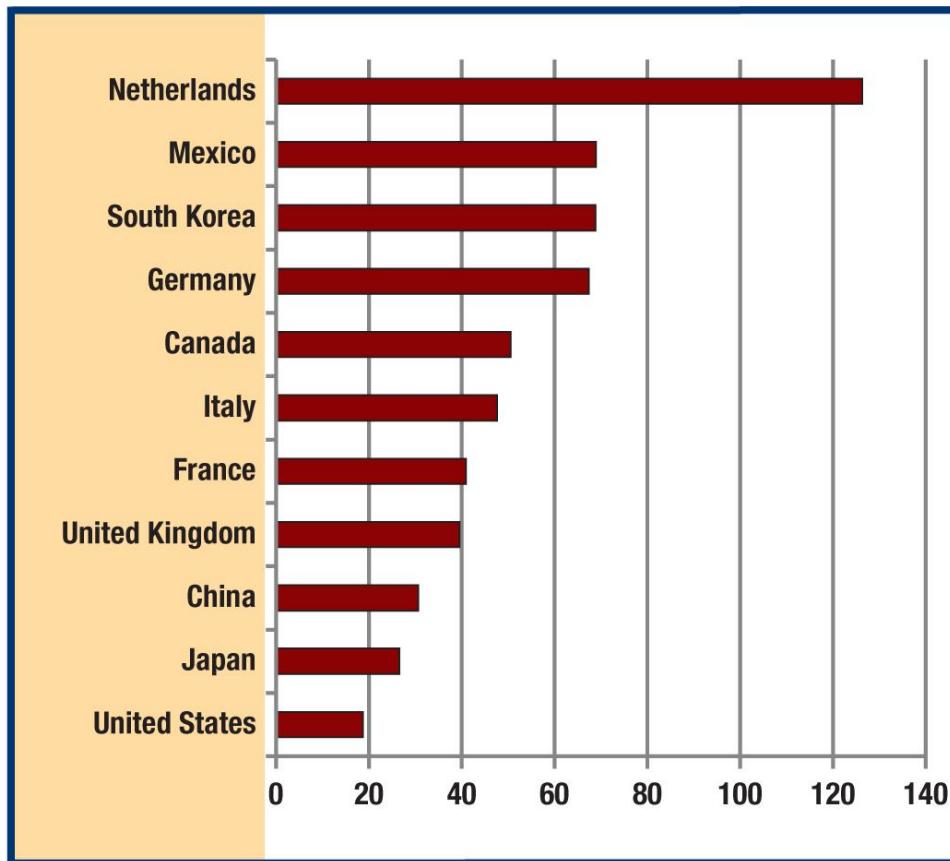


(a) Total annual value of products trade (exports + imports)
in billions of U.S. dollars

Sources: Based on data from the World Bank, World Development Indicators, World Bank, Washington, World Trade Based on data from the World Trade Organization, Statistics Database, Geneva: World Trade Organization (2017),

- www.wto.org • ; UNCTAD, World Investment Report, New York: United Nations
- www.unctad.org (2017),

Leading Countries in International Merchandise Trade, Total Value as a % of G D P

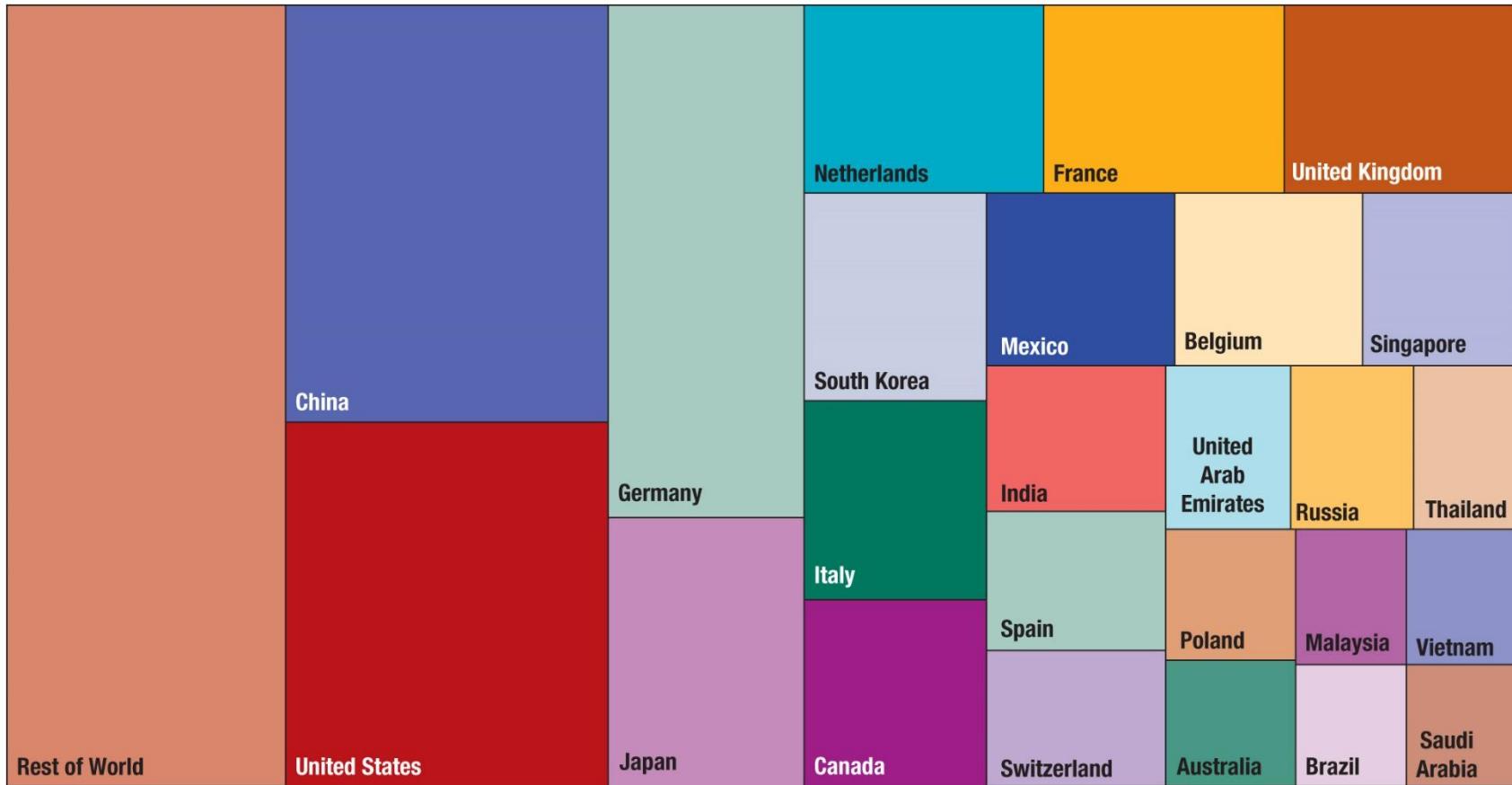


(b) Total annual value of products trade (exports + imports)
as a percentage of nation's GDP

Sources: Based on data from the World Bank, World Development Indicators, World Bank, Washington, World Trade Based on data from the World Trade Organization, Statistics Database, Geneva: World Trade Organization (2017),

- www.wt.o.org • ; UNCTAD, World Investment Report, New York: United Nations
- www.uncta.d.org

Top 25 Countries in International Merchandise Trade

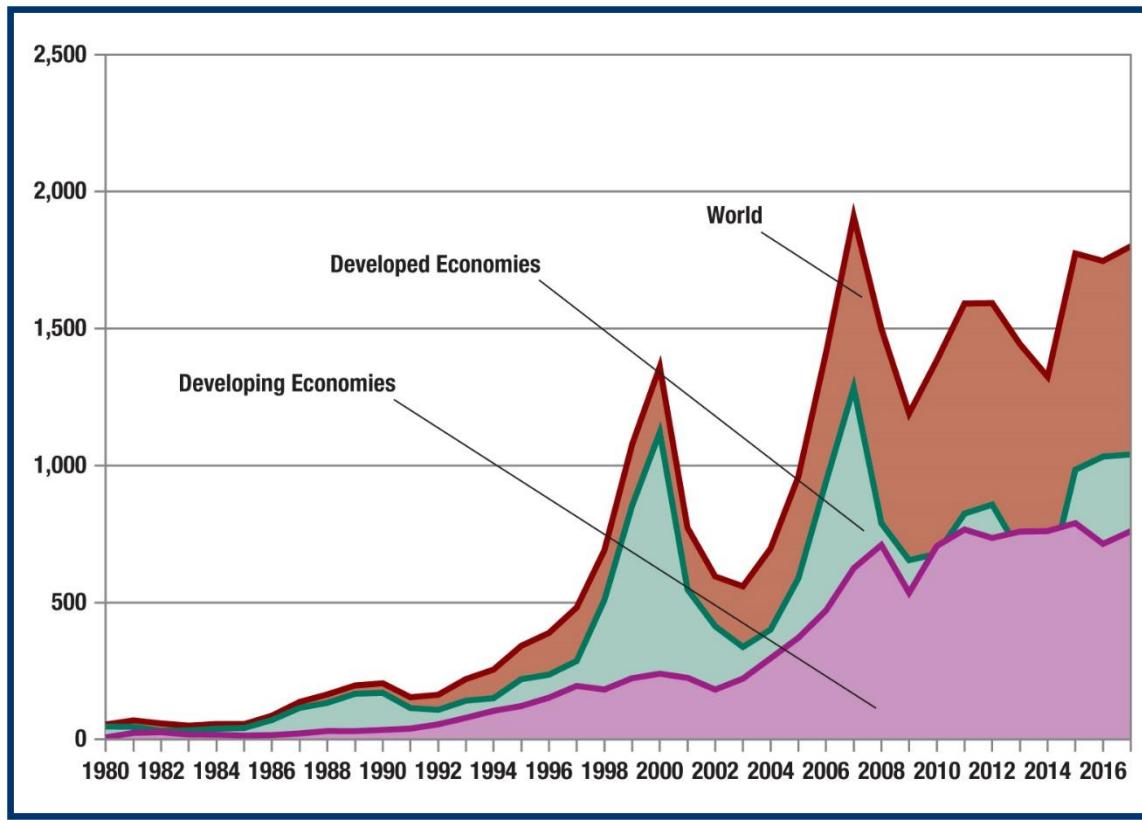


Sources: Based on data from the World Bank, World Development Indicators, Washington, DC: World Bank (2017), UNCTAD,

- www.worldbank.org • ; World Trade Organization, Statistics Database, Geneva: World Trade Organization
- www.wto.org • unctad.org (2017); World Investment Report, New York: United Nations
- www.unctad.org

• Note: The exhibit reflects the value of each country's combined exports and imports as a percentage of total world trade.

FDI Inflows into World Regions (in Billions of U.S. Dollars per Year)



- Sources: UNCTAD, UNCTADSTAT Database, Inward FDI Flows, Annual (2017); OECD, FDI Flows (2017),
- <https://data.oecd.org/fdi/fdi-flows.htm>
- <http://data.worldbank.org>
- World Bank, Foreign Direct Investment, Net Inflows (BoP, Current US\$) (2017),

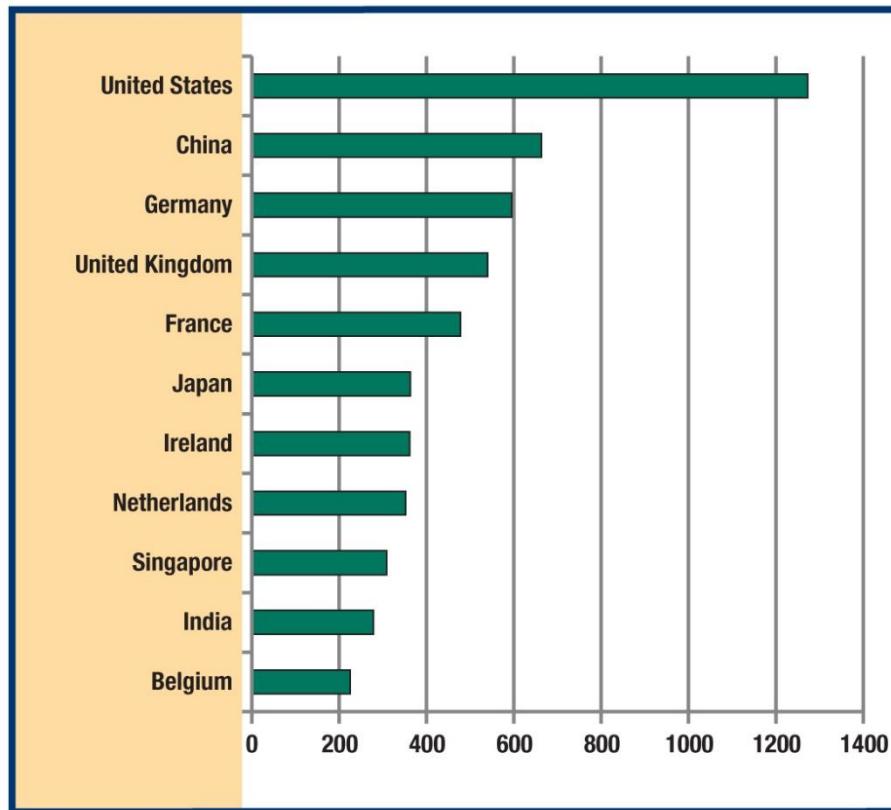
Service Industries that are Rapidly Internationalizing

Industry	Representative Activities	Representative Companies
Architectural, construction, and engineering	Construction, power utilities, design, engineering services, for airports, hospitals, dams	ABB, Bechtel Group, Halliburton, Kajima, Philip Holzman, Skanska AB
Banking, finance, and insurance	Banks, insurance, risk evaluation, management	Bank of America, CIGNA, Barclays, HSBC, Ernst & Young
Education, training, and publishing	Management training, technical training, language training	Berlitz, Kumon Math & Reading Centers, NOVA, Pearson, Elsevier
Entertainment	Movies, recorded music, Internet-based entertainment	Time Warner, Sony, Virgin, MGM
Information services	E-commerce, e-mail, funds transfer, data interchange, data processing, computer services	Infosys, EDI, Hitachi, Qualcomm, Cisco
Professional business services	Accounting, advertising, legal, management consulting	Leo Burnett, EYLaw, McKinsey, A.T. Kearney, Booz Allen Hamilton
Transportation	Aviation, ocean shipping, railroads, trucking, airports	Maersk, Santa Fe, Port Authority of New Jersey, SNCF (French railroads)
Travel and tourism	Transportation, lodging, food and beverage, aircraft travel, ocean carriers, railways	Carlson Wagonlit, Marriott, British Airways

Service Industries that are Rapidly Internationalizing

- Historically, international trade and investment were mainly the domain of companies that make and sell *products*—tangible merchandise such as clothing, computers, and cars. Today, firms that produce *services* (intangibles) are key international business players as well.
- Services are deeds, performances, or efforts performed directly by people working in banks, consulting firms, hotels, construction companies, retailers, and countless other firms in the services sector.
- For example, if you own a house, your mortgage may be underwritten by the Dutch bank ABN Amro. Perhaps you eat lunch in a cafeteria owned by the French firm Sodexho, which manages the food and beverage operations on numerous university campuses.
- In the United States and several European countries, travel and tourism are now the number-one source of revenue from foreigners
- In recent years, services trade has been growing faster than products trade.

Leading Countries in International Services Trade, by Total Annual Value, \$Billions

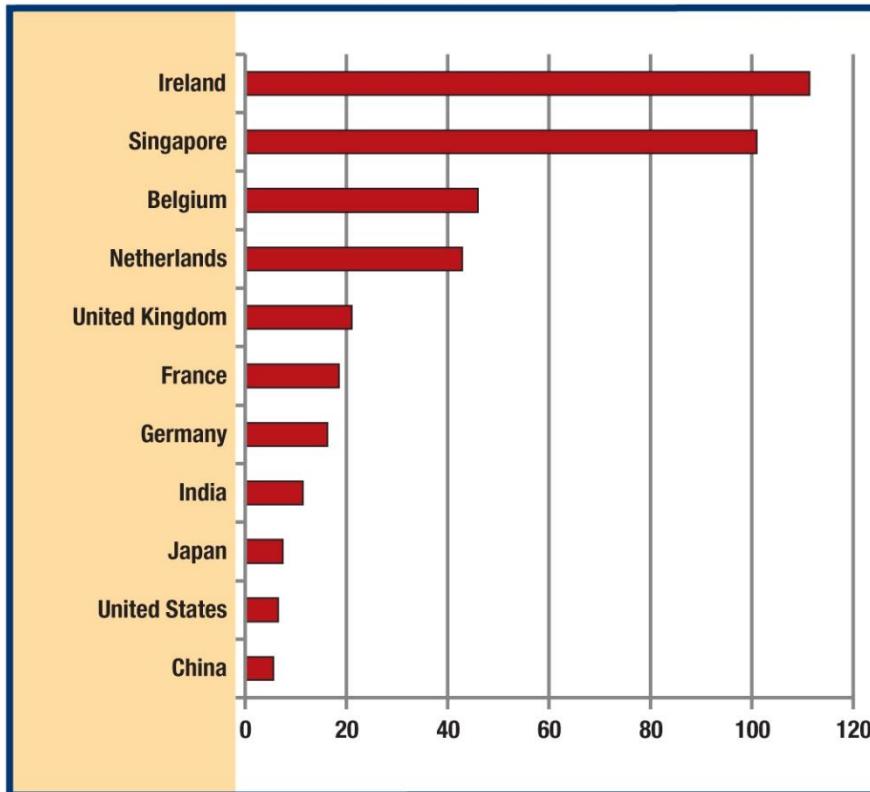


(a) Total annual value of services trade (exports + imports)
in billions of U.S. dollars

Sources: Based on data from the World Bank, World Development Indicators, Washington, DC: World Bank (2017),

- www.worldbank.org • ; World Trade Organization, Statistics Database, Geneva: World Trade Organization
- www.wto.org
- UNCTAD, "International Trade in Goods and Services," UNCTADSTAT
- www.unctad.org

Leading Countries in International Services Trade, Total Value as a % of GDP



(b) Total annual value of services trade (exports + imports)
as a percentage of nation's GDP

Sources: Based on data from the World Bank, World Development Indicators, Washington, DC: World Bank (2017),

• www.worldbank.org • ; World Trade Organization, Statistics Database, Geneva: World Trade Organization

www.wto.org • ; UNCTAD, "International Trade in Goods and Services," UNCTADSTAT • www.unctad.org
(2017), (2017)

International and Domestic Business: How They Differ

- 1. International business....**
 - is conducted across national borders,
 - uses distinctive business methods,
 - is in contact with countries that differ in terms of culture, language, political system, legal system, economic situation, infrastructure, and other factors
- 2. Stated differently, when they venture abroad, firms encounter four major types of risk**



Ethical Connections

- In the fashion industry, hundreds of factory workers die annually from dangerous working conditions.
 - In the production of faded denim jeans, thousands of garment workers develop deadly lung diseases from constant exposure to crystalline silica used to sandblast jeans to give them the worn, vintage look.
 - Illegal in Europe and the United States, such production methods are still widely used in low-income countries, from where the jeans are then distributed to affluent consumers worldwide.
- Source: G. Brown, "Fashion Kills: Industrial Manslaughter in the Global Supply Chain," EHS Today, September 2010, p. 59.



- Internationalizing firms are routinely exposed to four major types of risk, as illustrated in the exhibit:
 - cross-cultural risk,
 - country risk,
 - currency risk, and
 - commercial risk.
- The firm must manage these risks to avoid financial loss or product failures.

The Four Risks of International Business

- Cultural differences
- Negotiation patterns
- Decision-making styles
- Ethical practices

Cross-Cultural Risk

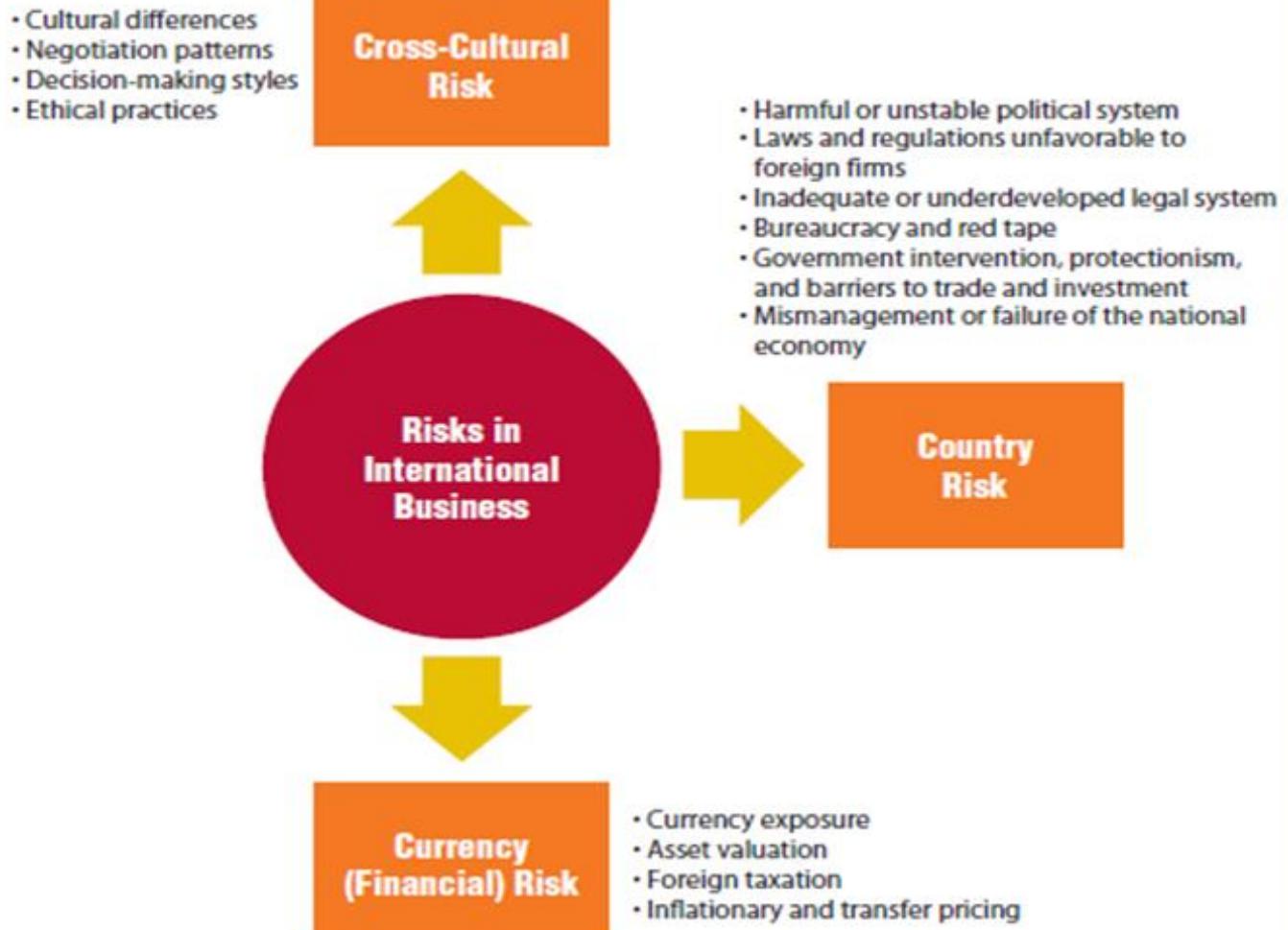


The Four Risks of International Business

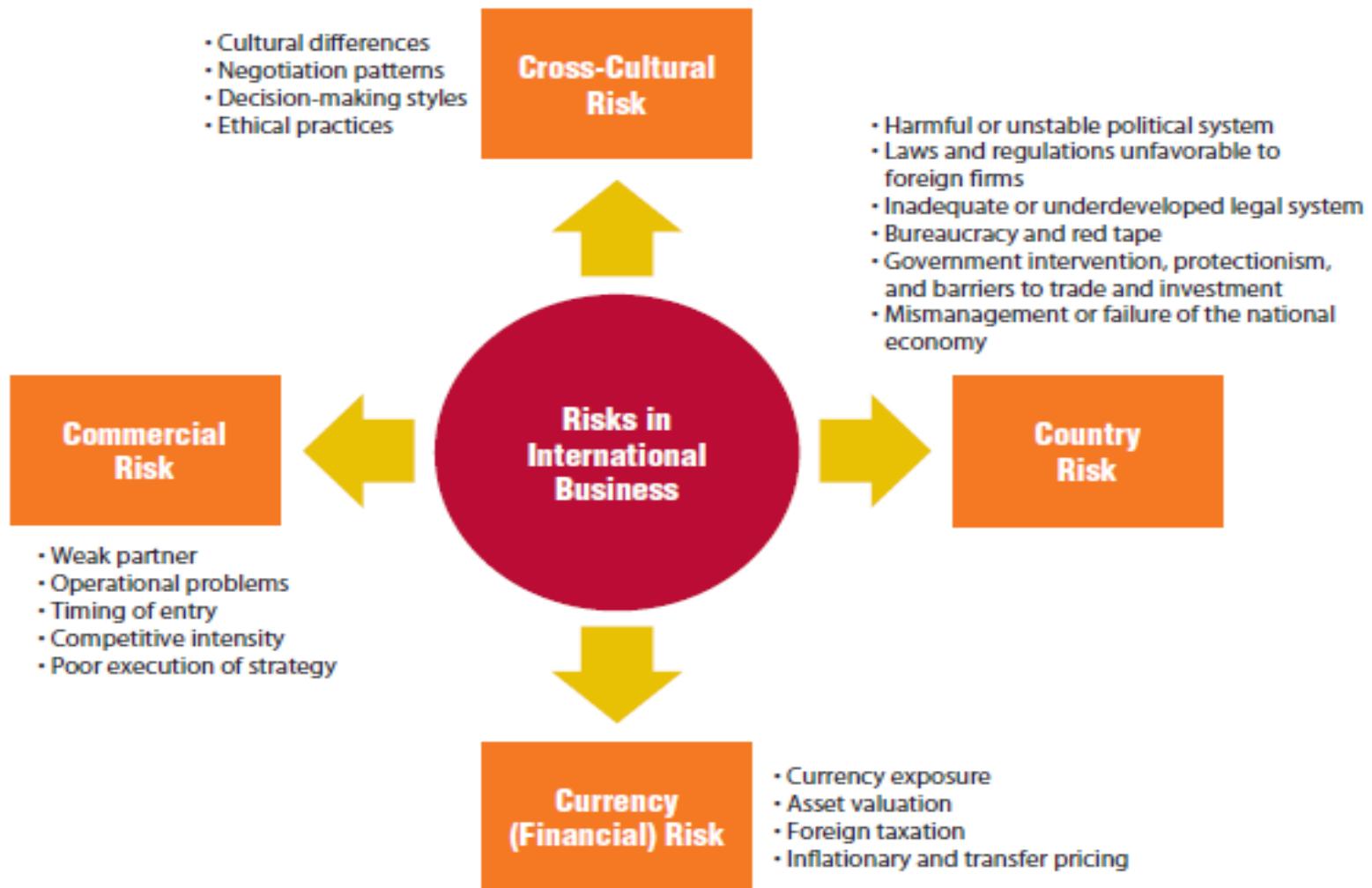
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- The diagram illustrates the three main types of risks in international business:
- Cross-Cultural Risk** (Orange Box):
 - Cultural differences
 - Negotiation patterns
 - Decision-making styles
 - Ethical practices
 - Country Risk** (Orange Box):
 - Harmful or unstable political system
 - Laws and regulations unfavorable to foreign firms
 - Inadequate or underdeveloped legal system
 - Bureaucracy and red tape
 - Government intervention, protectionism, and barriers to trade and investment
 - Mismanagement or failure of the national economy

Risks in
International
Business

The Four Risks of International Business



The Four Risks of International Business



Cross-Cultural Risk

- **Cultural Differences.** Risk arising from differences in language, lifestyle, attitudes, customs, and religion, where a cultural miscommunication jeopardizes a culturally-valued mindset or behavior.
- Values unique to a culture tend to be long-lasting and transmitted from one generation to the next. These values influence the mind-set and work style of employees and the shopping patterns of buyers.
- Foreign customer characteristics differ significantly from those of buyers in the home market.



Cross-Cultural Risk

- **Language** is a critical dimension of culture. In addition to facilitating communication, language is a window on people's value systems and living conditions.
- For example, Inuit (Eskimo) languages have various words for snow, while the South American Aztecs used the same basic word stem for snow, ice, and cold. When translating from one language to another, it is often difficult to find words that convey the same meanings.
- For example, a one-word equivalent to aftertaste does not exist in many languages. Such challenges impede effective communication and cause misunderstandings.
- Miscommunication due to cultural differences gives rise to inappropriate business strategies and ineffective relations with customers.
- Cross-cultural risk most often occurs in encounters in foreign countries. However, the risk also can occur domestically, as when management meets with customers or business associates who visit company headquarters from abroad.



Cross-Cultural Risk

- **Negotiation Patterns.** Negotiations are required in many types of business transactions. E.g., where Mexicans are friendly and emphasize social relations, Americans are assertive and get down to business quickly.



Cross-Cultural Risk

- **Decision-Making Styles.** Managers make decisions continually on the operations and future direction of the firm. For example, Japanese take considerable time to make important decisions. Canadians tend to be decisive, and ‘shoot from the hip’.
- **Ethical Practices.** Standards of right and wrong vary considerably around the world. For example, bribery is relatively accepted in some countries in Africa, but is generally unacceptable in Sweden.



Country Risk (Political Risk)

- Refers to the potentially adverse effects on company operations and profitability caused by developments in the political, legal, and economic environment in a foreign country.
- Country risk includes the possibility of foreign government intervention in firms' business activities.
- Government intervention, protectionism, and barriers to trade and investment.



Country Risk (Political Risk)

- Bureaucracy, red tape, administrative delays, corruption
- Lack of legal safeguards for intellectual property rights
- Legislation unfavorable to foreign firms
- Economic failures and mismanagement
- Social and political unrest and instability

Examples

- The U.S. imposes high tariffs on imports of sugar and other agricultural products.
- Doing business in Russia often requires paying bribes to government officials.
- Venezuela's government has interfered much with the operations of foreign firms.
- Argentina has suffered high inflation and other economic turmoil.



Currency Risk (Financial Risk)

- **Currency exposure.** General risk of unfavorable exchange rate fluctuations.
- **exchange rates**—the value of one currency in terms of another
- **Asset valuation.** Risk that exchange rate fluctuations will adversely affect the value of the firm's assets and liabilities.
- **Foreign taxation.** Income, sales, and other taxes vary widely worldwide, with implications for company performance and profitability.
- **Inflation.** High inflation, common to many countries, complicates business planning, and the pricing of inputs and finished goods.

Examples

- The Indian rupee has fluctuated a lot since 1990.
- The U.S. has relatively high corporate income taxes.
- Brazil and Russia have experienced very high inflation.



Commercial Risk

- **Commercial risk** refers to the firm's potential loss or failure from poorly developed or executed business strategies, tactics, or procedures.
- Managers may make poor choices in such areas as the selection of business partners, timing of market entry, pricing, creation of product features, and promotional themes.



Commercial Risk

- Weak partner
- Operational problems
- Timing of entry
- Competitive intensity
- Poor execution of strategy



General commercial risks such as these lead to sub-optimal formulation and implementation of the firm's international value-chain activities.

The Four Risks of IB: Conclusion

- Always present but manageable
- Managers need to understand, anticipate, and take proactive action to reduce their effects.
- Some risks are extremely challenging.

Example

The recent global financial crisis generated many commercial, currency, and country risks, affecting banks and other firms worldwide, and leading to steep declines in national stock markets and normal business activity.

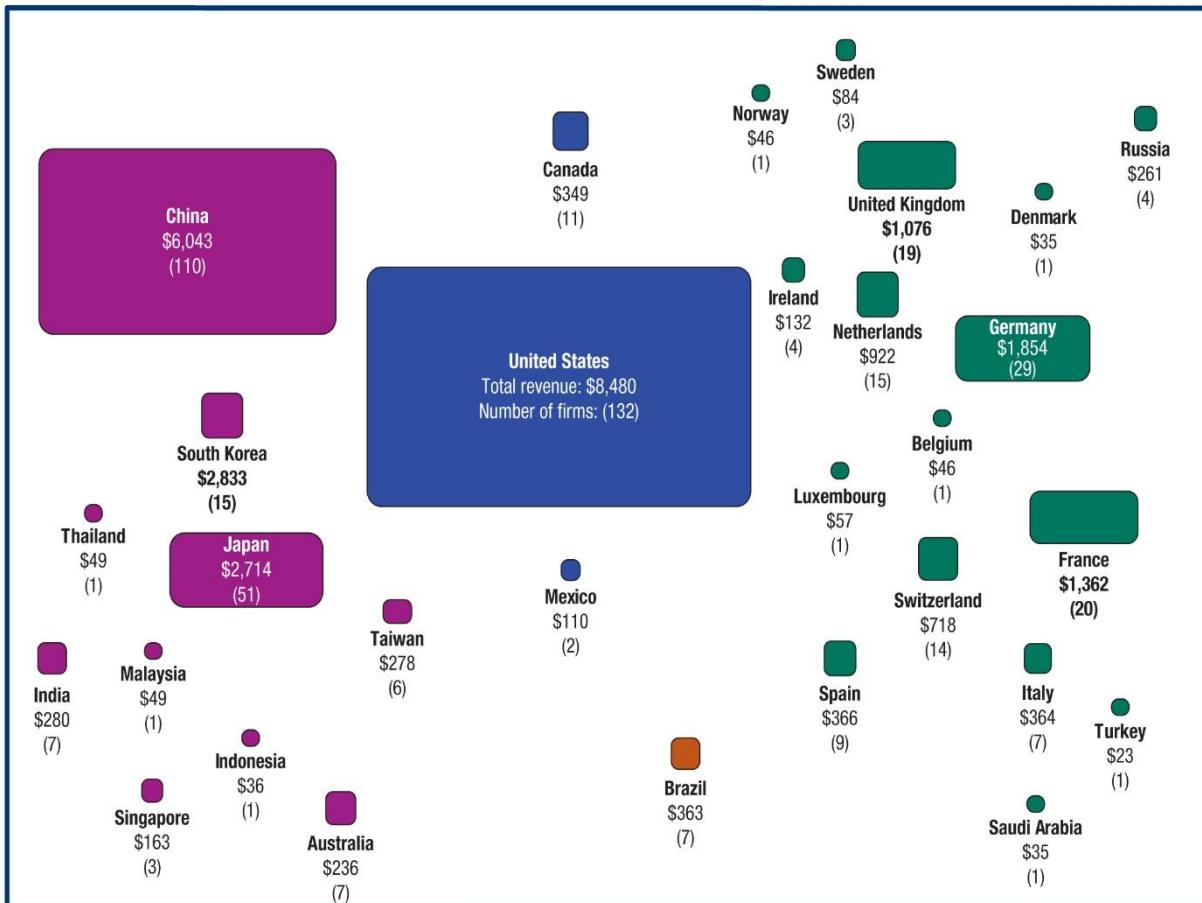


Who Participates in International Business?

- **Multinational enterprise (MNE):** A large company with substantial resources that performs various business activities through a network of subsidiaries and affiliates located in multiple countries. E.g., Caterpillar, Samsung, Unilever, Vodafone, Disney.
- **Small and Medium-Sized Enterprise (SME):** Typically, companies with 500 or fewer employees, comprising over 90% of all firms in most countries. SMEs increasingly engage in international business.
- **Born global firm:** A young, entrepreneurial SME that undertakes substantial international business at or near its founding.



Geographic Locations of the 500 Largest Multinational Enterprises



- Sources: Scott Decarlo, "Global 500," Fortune (2017), pp. 18-19; Fortune, "Global 500," Special Section, July 21, 2014, pp. F1-F8. Note: The exhibit shows country name, total revenues of Global 500 firms in U.S. dollars, and total number of Global 500 firms.
- <http://fortune.com>

Who Participates in International Business? (cont'd)

- **Non-governmental organizations:** Many of these non-profit organizations conduct cross-border activities. They pursue special causes and serve as advocates for social issues, education, politics, and research.

Examples

- *The Bill and Melinda Gates Foundation* and the *British Wellcome Trust* both support health and educational initiatives.
- *CARE* is an international non-profit organization dedicated to reducing poverty.



Non-governmental organizations



Why do Firms Participate in IB?

- ***Seek opportunities for growth through market diversification.*** E.g., Harley-Davidson, Sony, Whirlpool.
- ***Earn higher margins and profits.*** Often, foreign markets are more profitable.
- ***Gain new ideas about products, services, and business methods.*** E.g., GM refined its knowledge for making small, fuel-efficient cars in Europe.



Why do Firms Participate in IB? (cont'd)



Better serve key customers that have relocated abroad. E.g., when Toyota launched its operations in Britain, many of its suppliers followed suit.

Be closer to supply sources, benefit from global sourcing advantages, or gain flexibility in the sourcing of products. E.g., Dell sources parts and components from the best suppliers worldwide.

Why do Firms Participate in IB? (cont'd)

- ***Gain access to lower-cost or better-value factors of production.*** E.g., Sony does much manufacturing in China.
- ***Develop economies of scale in sourcing, production, marketing, and R&D.***
E.g., Boeing lowers its overall costs by sourcing, manufacturing, and selling aircraft worldwide.



Why do Firms Participate in IB? (cont'd)

- ***Confront international competitors more effectively or thwart the growth of competition in the home market.*** Chinese appliance maker Haier established operations in the United States, partly to gain competitive knowledge about Whirlpool, its chief US rivals.
- ***Invest in a potentially rewarding relationship with a foreign partner.*** French computer firm Groupe Bull partnered with Toshiba in Japan to gain insights for developing information technology.



Why Should You Study IB?

- ✓ **Facilitator of the global economy and interconnectedness.** IB brings nations closer together.
- ✓ **Contributor to national economic well-being.** IB fuels economic growth and rising living standards.
- ✓ **A competitive advantage for the firm.** IB provides companies with many benefits, leading to profitability and competitive advantages



Why Should You Study IB? (cont'd)

- ✓ **A competitive advantage for you.** Working internationally offers a range of enlightening experiences, new knowledge, and other benefits that enhance careers....and it's exciting!
- ✓ **An opportunity for global corporate citizenship.** Firms must be ethical and socially responsible in their dealings because IB affects numerous constituents, often in unintended ways.



You Can Do It: Ashley Lumb

- Ashley is a real person, who got her undergraduate degree from a state university a few years ago. Read her profile in Chapter 1.
- Ashley's majors: Marketing and International business
- Reasons for pursuing career in international business: Adventure, perspective, career growth, and the opportunity to learn foreign languages
- Ashley's jobs since college:
 - Marketing Representative in Nice, France
 - Account Representative in Monte Carlo
 - Marketing Associate in Rome, Italy
 - Marketing Manager at Italian Vogue magazine



You Can Do It: Ashley Lumb (cont'd)

Ashley's Success Factors

- Hard work and networking.
- Ashley made a strong effort to meet lots of people. She sent out many resumes, asked a lot of questions, and researched job markets that interested her.
- To keep afloat between assignments, she worked several 'unglamorous' jobs.

Challenges

- Working abroad means stepping outside your comfort zone.
- May require following a career path that is nontraditional or not clearly defined .
- Language and culture barriers are ever present.

